IN THE

# Supreme Court of the United States

No. 76-568

OCTOBER TERM, 1976

WHITE & CASE and MARION JAY EPLEY, III,

*Petitioners,*

—v.—

SECURITIES AND EXCHANGE COMMISSION,

*Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of a divided panel of the United States Court of Appeals for the District of Columbia Circuit affirming the striking of an affirmative defense which, if allowed, would be dispositive of a protracted civil action brought by Respondent.

### Opinion Below

The opinion of the Court of Appeals is still unreported. It is set forth in Appendix A to the Petition.

## Jurisdiction

The opinion of the Court of Appeals was filed May 17, 1976. The Court of Appeals denied a suggestion for rehearing en banc on August 11, 1976; two judges voted for such rehearing. The order denying rehearing is set forth in Appendix B. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The jurisdiction of the District Court was based on 15 U.S.C. §§ 77v(a), 78u(f) and 78aa.

## Constitutional Provision and Regulation Involved

(1) The Fifth Amendment to the United States Constitution.

(2) A directive to its staff promulgated by the Securities and Exchange Commission on September 1, 1970.

These provisions are set forth in Appendices C and D to this Petition.

## Questions Presented

1. Whether the SEC staff was required by the Due Process Clause of the Fifth Amendment and an SEC directive to advise lawyers, who were representing clients in an SEC investigation, that the lawyers had themselves become unknowing targets of the investigation and to afford them an opportunity to present the reasons why they should not be sued by the Commission.

2. Whether the Court below, in holding that the SEC directive was discretionary rather than binding on the SEC staff, was entitled to rely on secret information never disclosed to Petitioners.



## Statement of the Case

### 1. *Introduction*

This Petition raises a question of first impression: whether, in the teeth of its own administrative regulation providing prospective defendants an opportunity to have their views presented to the Commission before being sued, the SEC could commence suit for alleged violations of the anti-fraud provisions of the federal securities laws against lawyers representing clients in an SEC investigation, without affording the lawyers any prior notice that they were prospective defendants or targets of the investigation or any opportunity to present the reasons why they should not be sued.

The SEC commenced such a suit without warning against White & Case and Mr. Epley,* notwithstanding the existence of a directive from the SEC to its staff requiring staff memoranda to the Commission recommending enforcement actions to set forth separately any factual or legal contentions advanced by a prospective defendant as to why he should not be sued.

The majority of the panel of the Court of Appeals held in a *per curiam* opinion, without citation of any case authority, that there was no "procedural infirmity, Constitutional or statutory, in the decision of the staff not to inform the prospective defendants that they were under investigation or to solicit their arguments as to why they should not be sued." (Appendix A, 5a-6a)

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* As we show below, the suit was brought on a novel theory of liability of professionals, and White & Case and Mr. Epley neither knew nor had reason to know they would be sued.

In dissent, Circuit Judge McGowan stated:

> "[T]he Commission directed its staff to transmit with all recommendations for the institution of formal proceedings the arguments of the prospective respondents against such action. *It is obvious that the policy could not be effectuated without notification being given to persons who were the targets of the staff investigations. That policy, although never publicly revealed, was in effect at the times relevant to this appeal, and on its face does not admit of any exceptions.* . . . [E]ven if discretion existed *vis a vis* the Commission, in relation to those under investigation, *problems of procedural fair play swarm around the question of how and why that discretion is exercised in a particular case.* That is especially true when, as here, professional advisers of clients under investigation are the *unknowing* targets. And it is not only the interests of those advisers that are affected adversely but those of the clients themselves." (Appendix A, 6a-7a) (emphasis supplied)

Moreover, the panel majority (as had the District Court) resolved this issue of administrative and constitutional law on the basis of secret materials which have never been disclosed to Petitioners at any point in this case. In order to determine whether the SEC directive to its staff was discretionary or binding, the District Court and the panel examined *in camera* 67 SEC documents relating to the background of the directive and the SEC's practice under it. Although the panel majority based its ruling in part on the documents, it held that the defense could be denied access to them. (Appendix A, 5a)

Judge McGowan dissented on this point as well. He stated that Petitioners should have the opportunity:

> "for discovery as to exactly what the Commission's policy was and the standards by which it was being applied generally as well as in this particular instance. As a start in this direction, the district court should make available to plaintiffs (*sic*) the materials examined by it *in camera*." (Appendix A, 7a)



### 2. *Proceedings Below*

The relevant facts from which this Petition arises are these:

The SEC brought a civil injunctive suit in February 1972, against National Student Marketing Corporation ("NSMC") and a number of other persons, including its outside lawyers and accountants, for alleged violations of the anti-fraud provisions of the federal securities laws. The SEC's widely publicized complaint against the lawyers raises novel and important questions of professional responsibility, among them the SEC's contention that lawyers may have a duty to act as informers against their clients to a governmental agency at the peril of being sued together with their clients if they fail to do so.*

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* The Commission alleged that upon the receipt of information adverse to their client during the closing of a merger transaction, White & Case and Mr. Epley (and the lawyers on the other side of the transaction) had a duty to "cease representing their respective clients and, under the circumstances, notify the plaintiff Commission . . . ." (J.A. 91-92); references are to the Joint Appendix in the court below).

A former SEC Commissioner has said that the complaint came "like a torpedo." Sommer, *Professional Responsibility: How Did We Get Here?* 30 [Special Issue] Bus. Law. 95, 101 (1975).

A commentary describes the case as follows:

> "The SEC's complaint in National Student Marketing, which is still pending, represents a substantial departure from traditional standards of care and priorities of duties for securities lawyers. The lawyers in National Student Marketing were not prime movers or principals willfully engaged in a scheme to mulct the investing public. They were not officers or directors of the companies involved, and they did not profit directly from the transactions in question. . . . [T]he lawyers were not

The defendants included the New York City law firm of White & Case, which had never before in its 75 year history been the subject of any complaint or charge of misconduct by any governmental body, and Marion Jay Epley, III, a partner in the firm, who has likewise enjoyed an unblemished reputation at the bar.

In 1968, White & Case had undertaken the representation in corporate and other matters of NMSC, a District of Columbia corporation engaged in marketing goods and services to the youth market. Mr. Epley was assigned to oversee NSMC matters in July 1969.

On February 24, 1970, the SEC issued an order for a so-called "private investigation" into whether NSMC, its officers, or directors had violated the federal securities laws (J.A. 5).* This investigation continued until February 3, 1972, the date on which the complaint was filed.

White & Case, as outside counsel, was requested by NSMC to represent the company in the SEC investigation. During this investigation, White & Case also represented six company officers and employees who testified before the SEC.

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involved, even in a strictly professional capacity, with any intentionally fraudulent securities scheme . . . ."

"The SEC's National Student Marketing complaint breaks new ground regarding priorities of duties as well as standard of care. No administrative or judicial precedent in the securities field even permits—much less requires—counsel to inform the government of his client's transgressions." Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties,* 74 Colum. L. Rev. 412, 421 (1974).

* Such investigations are conducted pursuant to Sections 8(e) and 20(a) of the Securities Act of 1933, 15 U.S.C. §§ 77h(e), 77t(a), and Section 21(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(a). The SEC's order of investigation made no reference to outside counsel as targets. (J.A. 4)



On September 1, 1970, while the NSMC investigation was in progress, the SEC promulgated the directive to its staff which is at issue here. In relevant part it provided:

> "Re: *Procedures Followed in the Institution of Enforcement Proceedings*
>
> *"The Commission has determined that the staff should adopt the following procedures in presenting its recommendations for enforcement actions to the Commission:"*
>
> • • • • •
>
> "In regard to both administrative proceedings and *injunctive actions,* the Commission requests that *the staff's memoranda to the Commision recommending the particular action set forth separately any argument or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation."* (J.A. 1-2) (emphasis supplied)

Despite this directive and the fact that White & Case and Mr. Epley were representing clients during the SEC investigation, the SEC staff never gave the slightest indication at any time prior to the filing of suit that the firm or its partner were themselves prospective defendants. Nor did the SEC staff ever give White & Case and Mr. Epley any opportunity to present their contentions to the SEC as to why they should not be sued along with their clients. Until the day of suit, White & Case and Mr. Epley were acting solely as lawyers for their clients in the investigation; they were afforded no chance to protect themselves against action by the Commission.

In an uncontroverted affidavit filed below, Paul J. Bschorr, an attorney at White & Case who represented NSMC and the six individuals during the investigation, stated:

"During my entire course of representation of NSMC and its officers and employees during the SEC private investigation, no SEC staff member advised me, informed me, warned me, or even implied to me that my firm or Mr. Epley were prospective defendants or potential targets. Indeed, although I appeared on behalf of various officers and employees of NSMC at investigational hearings, at no time did the SEC ever express any reservation to me as to the advisability of White & Case and myself continuing to represent NSMC, its officers and employees in the SEC proceeding nor did any member of the SEC staff ever raise the question of a possible or potential conflict in our continuing that representation." (J.A. 13-14)

During the proceedings below, it was ascertained that, at the same time the SEC staff was dealing with White & Case as counsel for its clients in the investigation, the staff was secretly recommending to the Commission that the lawyers should be sued together with their clients with respect to transactions which were the subject of the investigation. The consequences of the failure of the SEC staff to give any notice or warning to White & Case or Mr. Epley were set forth by Mr. Bschorr in his affidavit as follows:

"*Had I or my firm been advised at any time during* the *SEC investigation that White & Case and/or Mr. Epley were prospective defendants or targets in the investigation, we would have immediately taken steps to protect our clients and ourselves.* We would have advised our clients to seek other counsel to represent them in the SEC investigation in order to assure complete protection of the clients' interests and to provide continuity of legal representation in the event that a proceeding were brought against any of the clients. We would have considered retaining outside counsel for White & Case and Mr. Epley to protect the interests of our firm and Mr. Epley before the SEC and in any proceedings that might ensue." (J.A. 16) (emphasis supplied).*



Mr. Bschorr further stated that, if they had been warned that they were prospective defendants or targets of the investigation, White & Case and Mr. Epley would have availed themselves of the procedures provided by the Commission directive:

"We would have sought, through counsel, to present to the Commission staff and the Commission reasons why White & Case and Mr. Epley should not be named as defendants. We would have set forth, through counse', the facts and the law in order to show the Commission that suit against White & Case and Mr. Epley was unjustified. We would have availed ourselves of the opportunity to exercise important procedural rights before the Commission which the SEC staff prevented us from doing because they did not inform or advise us in any way that White & Case or its partner, Mr. Epley, was a target." (J.A. 16-17)

As indicated in Judge McGowan's dissent, the SEC's 1970 directive to its staff was never publicly revealed by the Commission. When its existence came to light during the proceedings below, we raised as an affirmative defense in the District Court that:

"The Securities and Exchange Commission violated its own rules, procedures, and directives and the United

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* Orison S. Marden, a senior partner of the firm, who died while this case was on appeal, likewise stated in an affidavit below:

"[A]t no time prior to February 3, 1972, the date of filing of the complaint in this action, was there any awareness by the firm that the Commission considered White & Case or our partner, Mr. Epley, as potential defendants in this or in any other legal proceeding. *Had there been even a suspicion that the propriety of our conduct as lawyers was being questioned by the Commission, the suspicion would have been brought to the attention of the Management Committee and the entire firm as well, as a matter of highest priority.*" (J.A. 19) (emphasis supplied)

States Constitution by instituting this action without informing defendants White & Case and Epley that they were prospective defendants or targets of the Commission investigation prior to the institution of the suit, and without affording defendants White & Case and Epley, or their counsel, an opportunity to present their contentions to the Commission or the Commission staff as to why they should not be sued." (J.A. 105)

The SEC, moving to strike the defense as insufficient as a matter of law, conceded that:

(1) "[T]he Commission instituted this action without informing any of the defendants that they were 'prospective defendants or targets' as such";

(2) "[N]one of the defendants was specifically provided 'an opportunity to present their contentions to the Commission or the Commission staff as to why they should not be sued'";

(3) With respect to "setting forth the contentions of prospective defendants in the staff memorandum to the Commission recommending this action, the Commission concedes for purposes of its motion to strike that the staff failed to advance such opposing views." (J.A. 109-110)*

The District Court thereafter rendered three separate and conflicting opinions on the validity of the defense. It first struck the defense on the ground that the 1970 directive was a rule "designed primarily for the benefit of the agency" rather than a rule "designed to protect the procedural rights of those subject to the agency's power . . . ." (J.A. 118)

* The District Court found that "[t]here is no dispute that the defendants were not given such advice [of their potential liability and their right to present their views to the Commission]." (J.A. 137)



Then, when the defendants pointed out that there had been no opportunity for discovery as to the purpose of the directive, the District Court reversed itself. It vacated its first opinion, reinstated the defense, acknowledged that it had made "factual determinations concerning the intent, purpose and reason for the 1970 memorandum which could not be resolved by the pleadings," and held that the defendants, "through discovery, should be permitted to develop a record under the circumstances." (J.A. 123)

Finally, after the defendants served a Rule 34 request on the SEC for production of documents which would illuminate the "intent, purpose and reason" for the 1970 directive, the District Court again reversed itself. This time it granted the SEC's motion to strike the defense on a theory not even hinted at in its first decision—that the 1970 directive was not a "rule" at all, but merely a "suggestion" to the agency staff creating "a totally discretionary procedure." (J.A. 148)

The Court precluded any discovery by White & Case and Mr. Epley of the documents called for by the Rule 34 request. The District Court made an *in camera* inspection of the 67 SEC documents concededly covered by the request and determined *ex parte*, without affording defense counsel access to any of the documents, that *none* of these documents was relevant to the meaning of the directive.

Recognizing the importance and novelty of the question presented, the District Court certified the validity of the defense for an interlocutory appeal pursuant to 28 U.S.C. § 1292(b); the Court of Appeals granted the petition for allowance of the appeal; expedited oral argument was held; and the decision of the panel and the denial of rehearing en banc followed.

## Reasons for Granting the Writ

This case raises questions of extraordinary importance to the Bar and to the fair conduct of administrative proceedings: whether the SEC violated its own regulation or denied basic due process protections to White & Case and Mr. Epley in bringing suit without warning against lawyers who were representing clients in the course of an investigation by the agency.

We ask: What possible justification can there be for concealing from lawyers in an investigation, whose clients are depending on them for the representation and protection of their rights and interests, the fact that the lawyers themselves are an unknowing target along with their clients? Fairness to both lawyer and client requires that both be apprised of such a critical fact so that both may take appropriate steps to safeguard their interests before the agency.*

Judge McGowan in his dissenting opinion emphasized the fundamental unfairness of hiding from a lawyer who

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* In a speech before the American Bar Association in 1974, an SEC Commissioner stated:

> "Not infrequently, in the course of an investigation, it appears that additional persons, sometimes attorneys, have been actively involved in the violation. When that appears, I think you would agree we should pursue the investigation in the newly indicated directions. *However, I would certainly agree that as soon as it appears that an attorney may be a subject of the inquiry himself, he should ordinarily be so informed, since then tough decisions must be made, such as whether he should continue to represent his client in view of his natural instinct, newly aroused, to protect his own interest.*" (A.A. Sommer, Jr., "The Commission and the Bar: Forty Good Years." August 14, 1974, at 11, Exhibit to Memorandum of White & Case and Marion Jay Epley, III, in Support of Motion for Reconsideration dated September 16, 1974) (emphasis supplied). Mr. Sommer was not a member of the Commission in 1972 when the present suit was filed.



is representing clients under investigation the fact that the lawyer is himself a target. Judge McGowan stated:

> "[I]t is not only the interests of those advisers that are affected adversely but that of the clients themselves. Is it seriously to be supposed that the lawyers here involved, if they had been apprised of their target status, would not have immediately withdrawn as counsel for the clients and, indeed, retained counsel for themselves?" (Appendix A, 7a).

No reason has ever been advanced to justify lack of notice to White & Case and Mr. Epley and denial of the opportunity to present their position to the Commission in advance of suit. The panel majority stated that "[m]andating such a procedure would seriously burden the Commission's enforcement procedure . . . ." (Appendix A, 6a). But neither the panel majority nor the SEC identified any way in which the Commission's enforcement functions could possibly have been impeded by giving White & Case and Mr. Epley notice and an opportunity to be heard before the SEC inflicted the severe injury to professional standing and reputation caused by the bringing of charges of fraud against a lawyer.*

Indeed, there is compelling evidence that notice and an opportunity to be heard would not in fact "seriously bur-

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* The Second Circuit has stressed the "damage to his professional reputation which might be occasioned by the mere pendency of such a charge" against a lawyer. *Meyerhofer* v. *Empire Fire & Marine Ins. Co.*, 497 F.2d 1190, 1195 (2d Cir. 1974), *cert. denied*, 419 U.S. 998. See also *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412, 422-23 & n.5 (1975).

In this case White & Case and Mr. Epley have been subjected to enormous burdens and expenses by this litigation, as well as continuing injury to their professional reputations, all unjustified. The defense is potentially dispositive of the litigation, and the Court of Appeals recognized the need for a prompt and definitive determination of the issue by allowance of an appeal under 28 U.S.C. §1292(b).

den" the Commission's enforcement procedures. In a landmark report issued in 1972, the SEC Advisory Committee on Enforcement Policies and Practices (known as the Wells Committee after its chairman, John A. Wells, of the New York Bar) expressly recommended that:

> "[E]xcept where the nature of the case precludes, a prospective defendant or respondent should be notified of the substance of the staff's charges and probable recommendation in advance of the submission of the staff memorandum to the Commission and be accorded an opportunity to submit a written statement to the staff which would be forwarded to the Commission together with the staff memorandum." *

There was no emergency to invoke here as a reason for departing from the procedures in the directive. The SEC's investigation took almost two years, and discovery in this case uncovered that the staff was actively considering suit against White & Case almost a year before the suit was filed.** The transactions challenged in the complaint occurred in 1968 and 1969. In its complaint filed in February 1972, the SEC sought only injunctive relief against future violations of the securities laws. The complaint did not request and the SEC has never applied for any interlocutory relief.

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* Wells Committee Report, June 1, 1972, reprinted in BNA Sec. Reg. & L. Rep., No. 158 Extra Edition, June 28, 1972. The two other members of the Committee were two former Chairmen of the Commission, Manuel F. Cohen and Ralph H. Demler.

** SEC Memorandum of Law to Richard H. Rowe from Alois Lubiejewski, Re: Possible Violations of the Securities Laws by John Glandon Davies, director and house counsel of NSMC; White & Case, counsel for NSMC; Peat, Marwick, Mitchell & Co., Certified Public Accountants, and Lord, Bissell, & Brook, counsel for Interstate National Corporation, dated March 26, 1971, listed as document number 21 in Appendix B to Mem. Op. dated June 25, 1974, J.A. 131.



The SEC's actions in this case are so completely at variance with settled principles of administrative law, due process, and fair procedure as to require correction by this Court.

**1. The Decision of the Court Below That the SEC Staff Was Not Required to Comply With the 1970 Directive Conflicts With the Decisions of This Court and Other Circuits and Is Incompatible With Due Process Requirements in Administrative Proceedings.**

A. The decision below cannot be reconciled with controlling authority in this Court or the decisions of other Circuits as to the duty of administrative agencies to observe their own regulations. It is noteworthy that the panel majority did not even attempt to deal with these authorities and did not cite a single case in support of its conclusion that staff non-compliance with the 1970 SEC directive could be excused because the directive was "discretionary".

This Court has repeatedly held that:

> "[R]egulations validly prescribed by a government administrator are binding upon him as well as the citizen, and . . . this principle holds even when the administrative action under review is discretionary in nature." *Service* v. *Dulles*, 354 U.S. 363, 372 (1957).

In *Service*, this Court set aside the discharge of an employee because the Secretary of State had adopted the recommendation of a Loyalty Review Board in violation of departmental regulations which required him to make an independent determination on the merits. This Court held:

> "While it is of course true . . . the Secretary was not obligated to impose upon himself these more rigorous

substantive and procedural standards, neither was he prohibited from doing so, . . . and having done so he could not, so long as the Regulations remained unchanged, proceed without regard to them." 354 U.S. at 388 (emphasis supplied)

This principle has been applied in numerous cases to invalidate administration action. See, *e.g., United States ex rel. Accardi* v. *Shaughnessy,* 347 U.S. 260 (1954); *Vitarelli* v. *Seaton,* 359 U.S. 535 (1959); *United States* v. *Heffner,* 420 F.2d 809 (4th Cir. 1969); *United States* v. *Leahey,* 434 F.2d 7 (1st Cir. 1970); *United States* v. *Coleman,* 478 F.2d 1371 (9th Cir. 1973); *Cason* v. *United States,* 471 F.2d 1225 (Ct. Cl. 1973); see also Note, *Violations by Agencies of Their Own Regulations,* 87 Harv. L. Rev. 629, 632 (1974).*

The principle of *Service* and *Accardi* was reaffirmed by this Court in *United States* v. *Nixon,* 418 U.S. 683 (1974), where the Court held the President bound by a regulation delegating authority to the Special Prosecutor. The Court stated: "So long as this regulation remains in force the Executive Branch is bound by it . . . ." 418 U.S. at 696.

As the Fourth Circuit has summarized the governing doctrine:

"An agency of the government must scrupulously observe rules, regulations, or procedures which it has established. When it fails to do so, its action cannot stand and courts will strike it down." *United States* v. *Heffner,* 420 F.2d 809, 811 (4th Cir. 1969).

This precept applies to an agency violation of its own procedures, regardless of the form in which the pro-

* The doctrine is not limited to agency action of an adjudicative nature or to cases in which the agency itself imposes a sanction. It applies equally to agency action leading up to the institution of charges which will be adjudicated in a court. *United States* v. *Leahey,* 434 F.2d 7, 9 (1st Cir. 1970); *United States* v. *Heffner,* 420 F.2d 809 (4th Cir. 1969).



cedures are embodied or the label attached to them. Thus, in *United States* v. *Heffner, supra,* the Fourth Circuit held that a federal court could not admit evidence which had been obtained in violation of "instructions to all Special Agents of the Intelligence Division" that were announced in the format of an "IRS News Release." 420 F.2d at 811. In invalidating the administrative action, the Court stated:

"Nor does it matter that these IRS instructions to Special Agents were not promulgated in something formally labeled a 'Regulation' or adopted with strict regard to the Administrative Procedure Act; the Accardi doctrine has a broader sweep. The Supreme Court in *Vitarelli* v. *Seaton,* [359 U.S. 535 (1959)], applied it to a Department of Interior 'Order.' The Second Circuit has applied it to the Army's 'Weekly Bulletin 42' [citing *Smith* v. *Resor,* 406 F.2d 141 (2d Cir. 1969)]. The District of Columbia Circuit has applied the doctrine to an FCC 'Rule' which had not been formally promulgated but which the court found had been established by the FCC's 'usual practice' of including the rule in its orders [citing *Sangamon Valley Television Corp.* v. *United States,* 106 U.S. App. D.C. 30, 269 F.2d 221 (1959)]. . . . The same court has also applied the doctrine to FCC 'Standards' [citing *American Broadcasting Co.* v. *FCC,* 85 U.S. App. D.C. 343, 179 F.2d 437 (1949)]. Finally, in *United States ex rel. Brooks* v. *Clifford,* 409 F.2d at 706, this court applied the doctrine to a Department of Defense 'Directive'."

"These cases are consistent with the doctrine's purpose to prevent the arbitrariness which is inherently characteristic of an agency's violation of its own procedures. 420 F.2d at 812 (emphasis supplied)*

* The Seventh Circuit has held:

"An agency may be bound by its own established custom and practice as well as by its formal regulations." *Briscoe* v. *Kusper,* 435 F.2d 1046, 1055 (7th Cir. 1970).

What matters is not form or label, but substance. The 1970 SEC directive deals with a matter of fundamental fairness and vital importance to a prospective defendant—the opportunity to present his side to the Commission before it takes the drastic step of leveling charges of securities law fraud against him. In the case of a lawyer representing clients before the Commission, the matter is of critical importance not only to the lawyer but to the clients as well, and the unfairness and damage are compounded by a departure from the regulation.

To label this SEC directive "discretionary," as the court below did, does violence to its language, context, and purpose. It trivializes it to the level of some agency housekeeping matter like the size of the paper or the number of copies of a pleading.

The construction of the directive by the court below is manifestly unreasonable. Regulations dealing with procedural rights are not given a construction which could nullify them. On the contrary, they are read "against our underlying concepts of procedural regularity and basic fair play," so as to carry out their purpose. *Gonzales* v. *United States,* 348 U.S. 407, 412 (1955).

Furthermore, interpreting the directive as the court below did sanctions the over-reaching and concealment by SEC staff members which occurred in the present case. The purpose of the *Service-Accardi* rule is to prevent the administrative arbitrariness which results if officials are left free to pick and choose the persons to whom they grant or deny procedural rights. See *United States* v. *Heffner,* 420 F.2d 809, 812 (4th Cir. 1969); Note, *Violations by Agencies of Their Own Regulations,* 87 Harv. L. Rev. 629, 629-30 (1974). But the court below construed the



directive to permit the SEC staff complete discretion whether to warn a prospective defendant and give him an opportunity to be heard. The panel decision cannot be reconciled with the rationale of the *Service-Accardi* doctrine.

B. Even if the SEC staff had any measure of discretion under the directive whether to warn a prospective defendant, the manner of its exercise denied due process to White & Case and Mr. Epley. As Judge McGowan pointed out in his dissent, a construction of the 1970 directive as discretionary in no way validates the Commission's action. Although the Commission may choose to disregard staff noncompliance with its directive or purport to accord the staff discretion in applying it, from the standpoint of the person under investigation "problems of procedural fair play swarm around the question of how and why that discretion is exercised in a particular case." (Appendix A, 7a)

As we have indicated, the *Service-Accardi* rule is intended to preclude administrative arbitrariness by denying agency officials authority to accord different procedural treatment to similarly situated persons subject to their jurisdiction. In the present case the SEC made no showing at any point in the proceedings why the notice and opportunity to be heard accorded to other persons under the 1970 directive were denied to White & Case and Mr. Epley. There was no showing of any exigent or special circumstances impelling the staff to proceed as it did. On the contrary, as Judge McGowan pointed out, the instance of a lawyer representing a client in an investigation presents an unusually exigent case for giving warning so that both may take the necessary steps to protect their interests.

There is nothing in the record supporting the SEC staff's exercise of discretion, if it had any discretion, or rebutting the conclusion that the staff's action was arbitrary and without justification.

Indeed, as Judge McGowan further pointed out, the striking of the defense and the entry of the protective order against any discovery into the directive prevented any inquiry into "exactly what the Commission's policy was and the standards by which it was being applied generally as well as in this particular instance." (Appendix A, 7a) Were the decision below to stand, it would open the way to bureaucratic nullification of the *Service-Accardi* doctrine by establishing an unreviewable power in administrative officials to grant or withhold a procedure their agency chooses to characterize in retrospect as "discretionary." This Court should be vigilant to prevent any such erosion of the *Service-Accardi* principle.

**2. Deciding the Scope and Meaning of the 1970 SEC Directive on the Basis of Secret Materials to Which the Defense Was Denied Access Violated the Principle of *Alderman* v. *United States*.**

Both the District Court and the panel made an *in camera* examination of the 67 Commission documents covered by the defendants' Rule 34 request and made findings as to the "intent behind the 1970 directive" and the practice of the SEC staff under it. (Appendix A, 5a) The defendants were denied any access to any of these materials at any point. We have never had the opportunity to argue to either the District Court or the Court of Appeals as to the significance of these materials, because we have never been permitted to see them.



But it was on the basis of such *in camera* examination that the District Court concluded that the 1970 SEC directive was intended to be "discretionary" and the panel majority concluded that "there was a practice of notification, at the discretion of the staff, where such notification would not impede the investigation. There is no indication that the practice was regularly followed or that any such policy was ever established by the Commission." (*Id.*) Judge McGowan's examination did not lead him to either of these conclusions, since he urged that the District Court should be required to make the *in camera* materials available to the defendants.

The point is that dispositive issues as to the validity of the defense of White & Case and Mr. Epley—the meaning of the directive and the Commission staff's practice under it—were resolved against the defendants on the basis of secret information. We, as counsel, were denied the opportunity to provide effective assistance to our clients (as well as the court) on these issues because we were not permitted to see the documents.

The decision of the matter below by *in camera* inspection and reliance on undisclosed information is inconsistent with this Court's decisions in *Alderman* v. *United States*, 394 U.S. 165 (1969), *Kolod* v. *United States*, 390 U.S. 136 (1968), and other cases. This Court in *Alderman* expressed strong preference for the participation of counsel in such determinations, stressing the superiority of adversary proceedings "as a means for attaining justice in a given case," especially "where an issue must be decided on the basis of a large volume of factual materials, and after consideration of the many and subtle interrelationships which may exist among the facts reflected by these records." 394 U.S. at 183-184.

*Alderman* was not a new departure but a reaffirmation of this Court's longstanding commitment to adversary proceedings to determine disputed issues in both civil and criminal cases. Since the landmark decision in *Morgan* v. *Unted States,* 298 U.S. 468 (1936), this Court has repeatedly held that, except in extraordinary circumstances such as national security matters,* neither administrative nor judicial determinations should be made *ex parte,* without affording counsel a meaningful opportunity to be heard. See also *Morgan* v. *United States,* 304 U.S. 1 (1938); *Citizens to Preserve Overton Park* v. *Volpe,* 401 U.S. 402 (1971).

It is extraordinary that the District Court and the panel majority should have based their decision in a case of this consequence on secret information. The Seventh Circuit held in *Briscoe* v. *Kusper,* 435 F.2d 1046, 1057 (7th Cir. 1970):

> "Reliance upon evidence considered *in camera* as the basis for decision is fundamentally inimical to due process. [Citation omitted.] *Only the most exceptional circumstances can justify determinations based upon documents which interested parties may not examine.*" (emphasis supplied)

The decision of the panel majority in the present case is in conflict with these authorities. This Court should make plain that the techniques employed here are not an acceptable means of judicial determination of disputed issues.

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* No such claim is made here.



## CONCLUSION

For these reasons, a writ of certiorari should be granted.

Respectfully submitted,

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# APPENDICES

# APPENDIX A

## UNITED STATES COURT OF APPEALS

### For the District of Columbia Circuit

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No. 75-1700

Securities and Exchange Commission,

—v.—

National Student Marketing Corporation, *et al.*
White and Case and Marion Jay Epley, III,

*Appellants.*

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No. 75-1701

Securities and Exchange Commission,

—v.—

National Student Marketing Corporation, *et al.*
Lord, Bissel, Brook, Meyer and Schauer,

*Appellants.*

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No. 75-1702

Securities and Exchange Commission,

—v.—

National Student Marketing Corporation, *et al.*
Anthony M. Natelli & Joseph Scansaroli,

*Appellants.*

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Appeals from the United States District Court
for the District of Columbia

(Civil 225-72)

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Argued December 6, 1975
Decided May 17, 1976

*Daniel A. Rezneck,* with whom *Milton J. Freeman, Abe Krash* and *Lawrence A. Schneider* were on the brief, for appellants in No. 75-1700. *Steven M. Schatz* also entered an appearance for appellants in No. 75-1700.

*James A. Hourihan,* with whom *Sherwin J. Markman, Martin Michaelson* and *Dennis J. Whittlessey* were on the brief, for appellants in No. 75-1701.

*Mathias E. Mone,* with whom *William E. Hegarty* was on the brief, for appellants in No. 75-1702.

*David Ferber,* Solicitor, Securities and Exchange Commission, with whom *Frederic T. Spindel,* Assistant General Counsel and *Lawrence A. Horn,* Attorney Securities and Exchange Commission, were on the brief, for appellee. *Van P. Carter,* Attorney Securities and Exchange Commission, also entered an appearance for appellee.

Before McGowan, Tamm and Robb, *Circuit Judges.*

Opinion *per curiam.*

Dissenting opinion filed by *Circuit Judge* McGowan.



*Per Curiam:* This appeal concerns an affirmative defense asserted in the answer of appellants White & Case and Epley as their Fifteenth Defense to a complaint by the Securities and Exchange Commission. That defense alleges:

> [T]he Securities and Exchange Commission violated its own rules, procedures, and directives and the United States Constitution by instituting this action without informing . . . [appellants] that they were "prospective defendants or targets" of the Commission investigation prior to the institution of the suit, and without affording . . . [appellants] or their counsel an opportunity to present their contentions to the Commission or the Commission staff as to why they should not be sued.

Amended Answer of Defendants White & Case and Marion Jay Epley, III, to the first Amended Complaint, April 9, 1973, ¶50; J.A. at 105.

The Commission moved to strike the Fifteenth Defense as legally insufficient. In response, appellants pointed to an internal, non-public memorandum of September 1, 1970, from the Commission to its senior staff, by which

> the Commission request[ed] that the staff memoranda to the Commission recommending the particular action set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation.

SEC Memorandum to All Division Directors and Office Heads, Re: Procedures Followed in the Institution of Enforcement Proceedings, September 1, 1970; J.A. 1-3. Ap-

pellants assert that this language embodies the directive which the Fifteenth Defense alleges the staff to have violated, and that the staff's departure from this procedure constitutes grounds for dismissal of this action.

The district court struck the Fifteenth Defense as legally insufficient, holding that the 1970 Memorandum was not designed for protection of prospective defendants' rights, but later vacated its decision and reinstated the Fifteenth Defense without prejudice to the Commission to renew its motion to strike. The latter order was based on the court's determination to ensure that no evidence relevant to the Commission's intent to issuing the 1970 Memorandum had been overlooked in the earlier ruling.

Appellants then requested production of various documents including memoranda prepared by individual Commissioners and agency staff members. The Commission responded by producing the only document issued by the Commission itself that referred to the 1970 Memorandum and related to the circumstances of its issuance, a minute of the Commission approving issuance of the 1970 Memorandum and dissemination to the staff. The Commission moved for a protective order respecting 67 other internal Commission documents that fell within the scope of the request and submitted the documents to the court for *in camera* inspection. The Commission contended that these internal documents were protected from disclosure by the intragovernmental privilege and that, in any case, none was relevant to the intent, reason or purpose of the Commission in issuing the 1970 Memorandum. At the same time, the Commission renewed its motion to strike the Fifteenth Defense on March 18, 1975. The district court granted the Commission's motions, concluding that none of the documents contained interpretive material or tended to support petitioners' claim that the 1970 Memorandum constituted a procedural directive or that non-compliance with the discretionary procedure could be a basis for dismissal. This appeal followed.



We affirm the order of the district court, satisfied that the court was correct in concluding that the Commission documents are "protected from disclosure by reason of the privilege for internal governmental memoranda containing advice or opinions," and that the privilege should not be over-ridden in this instance because "none of the requested documents [examined *in camera*] is relevant to the intent behind the 1970 directive." By way of explanation, the court further stated that none of the documents could indicate agency intent, since internal documents authored by agency staff or individual Commissioners "cannot be considered as an official expression of the will and intent of the Commission." The "great bulk of the documents requested . . . are not 'Commission-authored' but rather . . . consist with few exceptions, of memoranda among individual Commissioners, their legal assistants and Commission staff." Consequently, the court concluded that such documents could not be relied upon as indicators of agency intent.

At best, the documents indicate that there was a practice of notification, at the discretion of the staff, where such notification would not impede the investigation. There is no indication that the practice was regularly followed or that any such policy was ever established by the Commission. Given the novel nature of this cause, we see no procedural infirmity, Constitutional or statutory, in the decision of the staff not to inform the prospective defendants that they were under investigation or to solicit their argu-

ments as to why they should not be sued. Mandating such a procedure would seriously burden the Commission's enforcement procedure, already characterized by adequate due process safeguards. See 15 U.S.C. § 78u (1970). Had the Commission intended to establish a procedural rule which, if breached, would require dismissal of a complaint, we think it would have said so in language far clearer and more direct than that found in the 1970 Memorandum.

For these reasons, we affirm the action of the district court in striking the Fifteenth Defense.

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McGowen, *Circuit Judge, dissenting:* By reference to what is in the public record of this case, I can conclude only that in 1970 the Commission directed its staff to transmit with all recommendations for the institution of formal proceedings the arguments of the prospective respondents against such action. It is obvious that that policy could not be effectuated without notification being given to persons who were the targets of the staff investigations. That policy, although never publicly revealed, was in effect at the times relevant to this appeal, and on its face does not admit of any exceptions. We know also, however, that in a public release issued in 1972 the Commission characterized the practice it had been following as one permitting persons involved in a staff investigation, *on their request,* to submit to the Commission statements before staff recommendations for formal proceedings would be acted upon; and in that context the Commission stated the obviously correlative proposition that the staff, "in its discretion, may" take the necessary step of notifying investigation targets of the nature of the violations involved and the time available to them for making a submission to the Commisison.



But whether the staff did or did not have discretion at the times here in issue does not seem to me determinative of this appeal. For even if discretion existed *vis-a-vis* the Commission, in relation to those under investigation, problems of procedural fair play swarm around the question of how and why that discretion is exercised in a particular case. That is especially true when, as here, professional advisers of clients under investigation are the unknowing targets. And it is not only the interests of those advisers that are affected adversely but that of the clients themselves. Is it seriously to be supposed that the lawyers here involved, if they had been apprised of their target status, would not have immediately withdrawn as counsel for the clients and, indeed, retained counsel for themselves?

I am not prepared to say that the defense in issue should have been stricken by the district court without more exploration on the record of both the authority and the justifications for the staff's proceeding as it did in this case. That exploration can, in my judgment, best be achieved by directing the reinstatement of the defense in question at the present stage of the litigation, and of ventilating its merits or demerits at trial or, at the least, after further opportunity for discovery as to exactly what the Commission's policy was and the standards by which it was being applied generally as well as in this particular instance. As a start in this direction, the district court should make available to plaintiffs the materials examined by it *in camera.*

## APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 75-1700

SECURITIES AND EXCHANGE COMMISSION

—v.—

NATIONAL STUDENT MARKETING CORPORATION, *et al.*
WHITE AND CASE AND MARION JAY EPLEY, III,

*Appellants*

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No. 75-1701

SECURITIES AND EXCHANGE COMMISSION

—v.—

NATIONAL STUDENT MARKETING CORPORATION, *et al.*
LORD, BISSELL, BROOK, MEYER AND SCHAUER,

*Appellants*

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September Term, 1975

Civil Action 225-72

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Before: Bazelon, Chief Judge; Wright, McGowan, Tamm, Leventhal, Robinson, Robb and Wilkey, Circuit Judges.



## ORDER

The suggestion of Appellants White and Case and Marion Jay Epley, III for rehearing en banc having been transmitted to the full Court and there not being a majority of the Judges in regular active service in favor of having this case reheard *en banc,* it is

ORDERED by the Court *en banc* that the aforesaid suggestion for rehearing *en banc* is denied.

*Per Curiam*
For the Court:

GEORGE A. FISHER
*Clerk*

Chief Judge Bazelon and Circuit Judge McGowan would grant appellants' suggestion for rehearing *en banc.*

## APPENDIX C

Fifth Amendment to the United States Constitution

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.



## APPENDIX D

MEMORANDUM

September 1, 1970

To: All Division Directors and Office Heads

From: The Commission

Re: Procedures Followed in the Institution of Enforcement Proceedings

The Commission has considered the procedures currently followed in the institution of enforcement proceedings, both administrative proceedings and injunctive actions. The Commission has determined that the staff should adopt the followng procedures in presenting its recommendations for enforcement actions to the Commission:

In regard to administrative proceedings:

(1) Offers of settlement should not be negotiated prior to the time the staff presents its recommendation for administrative proceedings to the Commission. The staff should present its recommendations to the Commission as soon as possible after concluding its investigation or inquiry in the particular case.

(2) Before proceedings are recommended to the Commission, if the probable respondents desire to discuss settlement with the staff prior to the conclusion of the staff's investigation or inquiry, the staff should afford the parties involved an opportunity to present their proposals and arguments. The staff may, of course, discuss the facts of

the case with the parties and may indicate to them the nature of the violations which the staff believes have occurred. The staff should not, however, institute or suggest discussions of settlement or negotiate terms of settlement or indicate the particular recommendation the staff intends to make to the Commission, prior to the time the recommendation is submitted to the Commission.

(3) Where the statute allows, the Commission will ordinarily authorize private proceedings in order to avoid unnecessary publicity and to afford respondents in administrative proceedings time to discuss settlement with the staff after the proceedings are authorized, except in those cases that involve a need to alert public investors to continuing practices or acts which would operate as a fraud on such investors.

(4) After administrative proceedings have been authorized by the Commission, if a settlement is not reached in a reasonably short period of time, the case should proceed forthwith to a hearing.

In regard to injunctive actions:

(1) The staff should not negotiate consents to proposed injunctive actions prior to the time the Commission has authorized the bringing of the action. Recommendations for injunctive action should be presented to the Commission as soon as possible after the staff has concluded its investigation or inquiry in the particular case.

(2) If the probable defendants to a proposed injunctive action wish to discuss consents with the staff prior to the time the Commission authorizes the action, the staff should afford the parties involved an opportunity to present their



proposals and arguments. The staff may, of course, discuss the facts of the case with the parties and may indicate to them the nature of the violations which the staff believes have occurred. The staff should not, however, negotiate a consent or institute discussions relating to consents nor should it indicate the particular recommendation it intends to make to the Commission.

(3) If the Commission authorizes the action the complaint should be filed forthwith.

(4) If the defendants consent to all of the allegations and the relief prayed for in the complaint authorized by the Commission, it will not be necessary to submit the consent to the Commission for its approval. A consent which differs from the complaint should be submitted to the Commission for its approval.

In regard to both administrative proceedings and injunctive actions, the Commission requests that the staff's memoranda to the Commission recommending the particular action set forth separately any arguments or contentions as to either the facts or the law involved in the case which have been advanced by the prospective respondents and which countervail those made by the staff in its memoranda as a basis for the recommendation.